APPENDIX A

[Excerpts from Appendix A of the Brief of Respondent (Petitioner there) in United States Circuit Court of Appeals for the Third Circuit]

"Appendix A

Act of March 27, 1934, c. 95, 48 Stat. 503 [505]:

Sec. 3. The Secretary of the Navy is hereby directed to submit annually to the Bureau of the Budget estimates for the construction of the foregoing vessels and aircraft; and there is hereby authorized to be appropriated such sums as may be necessary to carry into effect the provisions of this Act: *Provided,* That no contract shall be made by the Secretary of the Navy for the construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof, herein, heretofore, or hereafter authorized unless the contractor agrees—

(a) To make a report, as hereinafter described, under oath, to the Secretary of the Navy upon the completion of the contract.

(b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract price, such amount to become the property of the United States: *Provided,* That if such amount is not voluntarily paid the Secretary of the Treasury may collect the same under the usual methods employed under the internal revenue laws to collect Federal income taxes.

(c) To make no subdivisions of any contract or subcontract for the same article or articles for

the purpose of evading the provisions of this Act, but any subdivision of any contract or subcontract involving an amount in excess of $10,000 shall be subject to the conditions herein prescribed.

(d) That the manufacturing spaces and books of its own plant, affiliates, and subdivisions shall at all times be subject to inspection and audit by any person designated by the Secretary of the Navy, the Secretary of the Treasury, and/or by a duly authorized committee of Congress.

(e) To make no subcontract unless the subcontractor agrees to the foregoing conditions.

The report shall be in form prescribed by the Secretary of the Navy and shall state the total contract price, the cost of performing the contract, the net income, and the per centum such net income bears to the contract price. A copy of such report shall be transmitted to the Secretary of the Treasury for consideration in connection with the Federal income tax returns of the contractor for the taxable year or years concerned.

The method of ascertaining the amount of excess profit to be paid into the Treasury shall be determined by the Secretary of the Treasury in agreement with the Secretary of the Navy and made available to the public. The method initially fixed upon shall be so determined on or before June 30, 1934: *Provided,* That in any case where an excess profit may be found to be owing to the United States in consequence hereof, the Secretary of the Treasury shall allow credit for any Federal income taxes paid or remaining to be paid upon the amount of such excess profit.

The contract or subcontracts referred to herein are limited to those where the award exceeds $10,000.

(U.S.C. 1940 ed., Title 34, Sec. 496.)

Act of June 25, 1936, c. 812, 49 Stat. 1926:

Section 3(b) of an Act entitled "An Act to establish the composition of the United States Navy with respect to the categories of vessels limited by the treaties signed at Washington, February 6, 1922, and at London, April 22, 1930, at the limits prescribed by those treaties; to authorize the construction of certain naval vessels; and for other purposes", approved March 27, 1934 (48 Stat. 505), is hereby amended * * * so that as amended said section 3(b) will read as follows:

'Sec. 3.(b) To pay into the Treasury profit, as hereinafter provided shall be determined by the Treasury Department, in excess of 10 per centum of the total contract prices, of such contracts within the scope of this section as are completed by the particular contracting party within the income taxable year, such amount to become the property of the United States, but the surety under such contracts shall not be liable for the payment of such excess profit: *Provided,* That if there is a net loss on all such contracts or subcontracts completed by the particular contractor or subcontractor within any income taxable year, such net loss shall be allowed as a credit in determining the excess profit, if any, for the next succeeding income taxable year: *Provided further,* That if such amount is not voluntarily paid the Secretary of the Treasury shall collect the same under the usual methods employed under the internal-revenue laws to collect Federal

income taxes: *Provided further,* That all provisions of law (including penalties) applicable with respect to the taxes imposed by Title I of the Revenue Act of 1934, and not inconsistent with this section, shall be applicable with respect to the assessment, collection, or payment of excess profits to the Treasury as provided by this section, and to refunds by the Treasury of overpayments of excess profits into the Treasury: *And provided further,* That this section shall not apply to contracts or subcontracts for scientific equipment used for communication, target detection, navigation, and fire control as may be so designated by the Secretary of the Navy, and the Secretary of the Navy shall report annually to the Congress the names of such contractors and subcontractors affected by this provision, together with the applicable contracts and the amounts thereof: *And provided further,* That the income-taxable years shall be such taxable years beginning after December 31, 1935, except that the above provisos relating to the assessment, collection, payment, or refunding of excess profit to or by the Treasury shall be retroactive to March 27, 1934.' (U.S.C. 1940 ed., Title 34, Sec. 496.)

T.D. 4723, 1937-1 Cum. Bull. 519, 521:

Art. 2. *Contracts and subcontracts under which excess profit liability may be incurred.* — Except as otherwise provided with respect to contracts or subcontracts for certain scientific equipment (see article 3 of these regulations), every contract awarded for an amount exceeding $10,000 and entered into after the enactment of the Act

of March 27, 1934, for the construction or manufacture of any complete naval vessel or aircraft, or any portion thereof, is subject to the provisions of the Act relating to excess profit liability. Any subcontract made with respect to such a contract and involving an amount in excess of $10,000 is also within the scope of the Act. If a contracting party places orders with another party, aggregating an amount in excess of $10,000, for articles or materials which constitute a part of the cost of performing the contract or subcontract, the placing of such orders shall constitute a subcontract within the scope of the Act, unless it is clearly shown that each of the orders involving $10,000 or less is a bona fide separate and distinct subcontract and not a subdivision made for the purpose of evading the provisions of the Act.

I.T. 2930, XIV-2 Cum. Bull. 533 (1936):

Advice is requested relative to the applicability to certain cases of section 3 of the Vinson Act (48 Stat. 503), which provides as follows:

* * * * * * *

The questions on which rulings are requested are stated and answered below:

* * * * * * *

(2) We are receiving orders for materials used in ship construction for the United States Navy and subject to the Vinson Act. We are desirous of obtaining your interpretation of this Act with regard to our status as subcontractors. As an example, take the case of a private shipyard placing an order with a manufacturer of condensers, who in turn would purchase the condenser

tubes from us—would we come under the jurisdiction of the Act in the event this order from the condenser manufacturer exceeds ten thousand ($10,000) dollars?

This question is answered in the affirmative. In this case the provisions of the Act are applicable to the contract, subcontract, or a subdivision thereof.

* * * * * * *

(4) We are desirous of obtaining your interpretation regarding contracts which we have with the United States Navy Department under the Vinson Act, as to whether or not the suppliers of materials used in the fabrication of our products would be considered subcontractors, and therefore, subject to the terms and conditions of the Vinson Act.

Generally speaking, section 3 of the Vinson Act is applicable to any contract or subcontract which is over $10,000 in amount and for the construction and/or manufacture of any complete naval vessel or aircraft, or any portion thereof, including items, such as fabricating materials, which become a component part of an article or articles constructed and/or manufactured under the Act.

OFFICE OF THE UNDER SECRETARY
OF THE NAVY, PROCUREMENT
LEGAL DIVISION,

PLD/RGMcC: vmc Washington, July 6, 1942.

Subject: Definition of word 'subcontractor' as used in Section 403, Sixth Supplemental National Defense Act, 1942 (Public Law No. 528, 77th Congress, approved March 27, 1942).

The question has been raised as to what is the proper definition of 'subcontractor' as used in the renegotiation provisions of the Sixth Supplemental National Defense Act, 1942. Practice under the Vinson-Trammel Act for the limitation of profits on contracts for the construction of naval vessels, appears to furnish the best precedents for arriving at such definition.

* * * * * * *

There are no Federal cases under the Vinson-Trammel Act and the related act applicable to Army aircraft contracts; and there do not appear to be any opinions of the Attorney General or of the Comptroller General bearing on the meaning of the word 'subcontract' in such acts.

However, the Judge Advocate General of the Navy has written several opinions as to the application of the Vinson-Trammel Act and these opinions are most helpful in determining what is meant by the word 'subcontract'. In a letter dated September 24, 1936, to The Paraffine Companies, Inc., the JAG said:

> Referring to your letter of August 29, 1936, stating that at times you furnish, as subcontractors, linoleums, paint and asphalt composition roofing for use in the construction of naval vessels, which material you consider as not coming within the purview of the Vinson-Trammel Act of March 27, 1934 (34 U.S.C. 496), this office is of the opinion that the above mentioned Act is applicable to all contracts and subcontracts for materials for complete naval vessels, aircraft or any portion thereof, provided the total contract or subcontract prices are in excess of $10,000.00 and that such materials have not been specifically designated by the Secre-

tary of the Navy as being exempt as scientific equipment under the authority contained in the amendatory Act of June 25, 1936 (Public No. 804).

In a letter to the Secretary of the Navy dated May 18, 1938, the JAG replied to a request as to whether contracts or subcontracts for material not forming a structural portion of the complete vessel fell within the classification of contracts or subcontracts for a 'complete Naval vessel or aircraft' or any portion thereof, as provided in the Act. The JAG cited the 1936 amendment to the Act which exempted therefrom certain scientific equipment, and then went on to say:

> In view of the foregoing, the Judge Advocate General is of the opinion that materials not forming a structural portion of the complete vessel are in general subject to the above mentioned acts, and that the administrative decision as to the exceptions to such rule must be made on the basis of a submission of the conditions affecting the procurement and use of specific items.

By an opinion dated December 16, 1938, to the Secretary of the Navy, the JAG replied to a request 'as to the application of the Vinson-Trammel Act to a contract for services only for the machining of Government owned castings and as to the distinction, if any, between a contract for services for the machining of castings, including the furnishing of jigs, dies and other materials used in the machining of the castings (a contract for services and materials), and a contract for the machining of the castings alone where no materials owned or produced by the machining contractor are delivered to the Government as a part of the service contract.' In this opinion he stated:

3. In the construction of the complete ship or of any portion thereof both labor and material are used; whether the labor and material are furnished by a single contractor or by several contractors, or whether one furnishes labor or services only and another the material, does not change the obligation of a contractor or subcontractor to pay into the Treasury excess profit where the contract or subcontract involves an amount in excess of $10,000.

4. In view of the foregoing, the Judge Advocate General is of the opinion that a contract or subcontract in excess of $10,000 for furnishing labor and material, or labor or material only, if necessary, at any stage, to produce material or equipment ultimately forming a portion of the complete Naval vessel or aircraft, is to be generally considered as coming within the scope of the above mentioned Act.

In January, 1939, the Secretary of the Navy requested the views of the Treasury Department as to the application of the Vinson-Trammel Act to a subcontract for ingots of copper and zinc to be used in the manufacture of cartridge cases. Mr. Hanes, the Acting Secretary of the Treasury, replied in part as follows:

In the specific instance stated, it is understood that the manufacturer (the prospective bidder in this case) is regularly engaged in using ingots of zinc and copper in the manufacture of articles not made under contracts coming within the Vinson-Trammel Act. It is not clear to this Department what the terms and conditions of the commitments referred to will be. It is assumed for purposes of this consideration that the ingot zinc and copper

is ordinary commercial raw zinc and copper which is in fact purchased for general use in the operations of the manufacturer and not for use exclusively in the construction and/or manufacture of articles covered by its contract under the Vinson-Trammel Act; and that the seller of the zinc and copper is not by agreement made subject to any term or condition imposed upon the manufacture under its contract with the Navy Department. The Treasury Department is of the opinion that under these circumstances such ingots of zinc and copper would not constitute portions of a complete naval vessel or aircraft within the scope of the Vinson-Trammel Act, as amended.

It is thus apparent that 'subcontractor' under the Vinson-Trammel Act was held to include a person who furnished materials and supplies under agreement with the contractor, or a person who furnished equipment, tools or machinery (jigs etc.) which were specifically furnished for the purposes of the contract alone (i. e. not for use in the general operation of the contractor's business). It would not appear that in the application of the Vinson-Trammel Act any attempt was made to go beyond the first tier of subcontractors; that is, there is nothing to indicate that it was applied to sub-subcontractors.

46 U.S.C. 1155 (b) (Merchant Marine Act, 1936) provides for a 10% profit limitation on Maritime Commission contracts, applicable to subcontracts, in language similar to the Vinson-Trammel Act. The Maritime Commission has issued regulations under this Act, defining 'subcontract' thus (Para. 22990 Prentice-Hall Government Contracts):

'Subcontract' means any agreement with a contractor for the construction of a complete vessel or portion thereof or for the manufacture or furnishing of any materials or goods or the rendering of any services directly for the construction thereof, but not including services rendered generally to the contractor in connection with the maintenance or operation of the shipyard and not including such intangibles as insurance, surety, expert consultation and the like, or agreements for the furnishing of drawings, plans and other technical information or data.

The practice under the profit limitation statutes appears therefore to have treated uniformly as subcontracts all agreements with the prime contractor relative to the article to be furnished under the prime contract, and there seems to be no justification for any distinction between persons supplying raw materials or machinery and equipment exclusively for use under the prime contract and any other subcontractor furnishing finished component parts of the article covered by the prime contract.

We are of the opinion that the term 'subcontract' as that term is used in Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942 includes the following agreements:

(a) Any purchase order from, or any agreement with, the contractor (i) to perform all or any part of the work to be done or to supply all or any part of the articles to be furnished, under his contract with the Government, (ii) to supply any services required directly for the production of any article or equipment covered by such contract or

any portion thereof, (iii) to make or furnish any supplies, materials, articles or equipment destined to become a component part of any article or equipment covered by such contract, or (iv) to make or furnish any machinery, equipment, tools or supplies acquired by the contractor exclusively for the performance of such contract, but shall not include any agreement to supply machinery, equipment, tools or supplies or other materials or services for the general operation of the contractor's plant or business;

(b) Any purchase order from, or any agreement with, a subcontractor who is obligated to furnish a portion of the completed articles called for under the agreement of the contractor with the Government, if such purchase order or agreement would be construed under paragraph (a) above as a subcontract if entered into with the contractor; and

(c) Any agreement of a subcontractor providing for the delivery to such subcontractor of a portion of the completed articles called for under his subcontract.

For the purpose of the foregoing definition the term 'contractor' must be deemed to be any person, firm or corporation that is a party to an agreement with the Government.

We have construed Section 403 of the Act as generally applicable only to subcontracts in the first tier, i. e., subcontracts entered into directly by the prime contractor with the Government. The renegotiation clause for inclusion in Navy contracts, pursuant to Section 403, as set forth in the letter of the Judge Advocate

General, dated May 30, 1942, approved by the Acting Secretary (JAG:P:FWL:em SO-28780), is keyed in with this construction of the Act, and contemplates inclusion of a renegotiation clause only in those subcontracts let by the prime contractor with the Government. We have, however, deemed it advisable in subparagraphs (b) and (c) above to include also, as within the term 'subcontract' as used in Section 403, certain subcontracts in the second tier of subcontracts. Subparagraph (b) covers the situation where the contractor with the Government has parcelled out or sublet a portion of his contract, in such manner that the subcontractor to whom he has sublet a portion of his contract will furnish to him the completed articles called for by the contract with the Government. In such case the subcontractor furnishing the completed articles called for by the agreement with the Government is, for the purposes of this statute, to be treated as the equivalent of a contractor with the Government, and any subcontracts let by such subcontractor (if they would be construed under subparagraph (a) as a subcontract if entered into with the contractor) are to be considered subcontracts as that term is used in Section 403.

Subparagraph (c) covers the situation where a subcontractor under an agreement with the contractor included within subparagraph (a) above, parcels out or sublets a portion of his subcontract; any agreement for the parcelling out or subletting of such subcontract should also be considered within the term 'subcontract' as that term is used in Section 403.

JOHN KENNEY,
RICHARD G. MCCLUNG."

APPENDIX B

[Excerpts from Brief of Petitioner (petitioner in the Board of Tax Appeals and respondent in the Circuit Court of Appeals) Before Those Tribunals]

(Before the Board of Tax Appeals)

"II.

In Computing Excess Profit, Metal Should be Included in 'Cost of Performing the Contract' at Its Value at the Time of Appropriation to the Contract.

This issue, which concerns the proper computation of the 'cost of performing the contract', applies to the prime contracts made by the petitioner with the Navy Department, and is the only issue raised with respect to those contracts. Alternatively, it also concerns the job contracts and material orders, as to which the petitioner insists that it is not subject to the Vinson Act because it was not a subcontractor. As to these, the petitioner takes the further position that even if it were a subcontractor, the 'cost of performing the contract' should in each instance, as in the case of prime contracts, be computed upon the basis of including metal at its 'schedule cost', i. e., its fair market value at the time it was set aside for performance of the particular contract. For convenience in our discussion of this issue, we shall ordinarily speak of the petitioner's prime contracts; the arguments made apply equally to job contracts and material orders.

At various times and in the ordinary course of its business, the petitioner produced or acquired and held in stock for its general corporate purposes metal consisting of pig aluminum, aluminum scrap, secondary aluminum ingot, and other metals used for alloying

(Stipulation, par. 2). Certain of this metal—not more than two per cent. of the entire amount—the petitioner appropriated for use in connection with the prime contracts, job contracts, and material orders involved in this case (R. 44). Until the metal was so appropriated and set aside, it was a part of an aggregate inventory of metal produced by the petitioner for commercial purposes to be fabricated and sold to commercial customers. The present issue concerns the price at which the metal is to be included in determining 'the cost of performing the contract'.

* * * * * * *

The petitioner accordingly contends that since the 'controlling date' is the date on which the metal was set aside for performance of the Navy contract, the 'cost' of materials to be included in the 'cost of performing the contract' is the fair market value of the materials at that controlling date.

* * * * * * *

On the basis of the foregoing authorities it would seem to follow *a fortiori* that the value at which the metal is to be taken into cost of performance should not be less than its value when the Vinson Act was passed. The Act is extreme in its impact upon business activities and calls for an outright taking rather than the imposition of a fractional tax, and for this reason the authorities under income tax and other laws holding that a retrospective application is not to be given to such laws apply with greater force here.

* * * * * * *

The principal against taxing preexisting profits (or seizing them outright, which is worse), was described in the *Turrish* case (247 U. S. 221, 230) as 'resistless except against an intention imperatively clear'. That

intention, we submit, is entirely lacking in the Vinson Act and, as we have pointed out, there is nothing in the regulations promulgated under that Act to call for retrospective application of its recapture provisions. If it should be determined, despite the authorities relied on by the petitioner, that in the case of metal produced after March 27, 1934, the original cost of the metal is to be included in the cost of performing the contract, the authorities above cited call in any event for the inclusion in cost of performance of metal on hand on the effective date of the Vinson Act at its fair market value on that date."

(Before the Circuit Court of Appeals)

"II.

The excess profit on a subcontract for the construction or manufacture of a vessel or aircraft authorized by the Vinson Act does not include profit resulting from an increase in the value of the metal occurring prior to the message of the act.

* * * * * * *

The question here is whether the Vinson Act is to have a retroactive application.

* * * * * * *

It cannot be said that there is anything in the Vinson Act justifying retroactive application, any more than in the 1909 or 1913 Acts construed by the Supreme Court.

* * * * * * *

That intention, we submit, is entirely lacking in the Vinson Act, and the Supreme Court decisions above cited call for the exclusion from the 'excess profit' derived from the construction of a Vinson Act naval vessel

or aircraft all profit resulting from the increase in the value of the metal occurring prior to the passage of the Act."

APPENDIX C

[Cases Holding That a Materialman Is Not a "Subcontractor"]

Staples v. Adams, Payne & Gleaves, 215 Fed. 322 (C.C.A. 4)

Northwest Roads Co. v. Clyde Equipment Company, 79 F. (2d) 771 (C.C.A. 9)

Hihn-Hammond Lumber Co. v. Elsom, 171 Cal. 570, 154 Pac. 12

John A. Roebling's Sons Co. v. Humboldt Electric Light & Power Co., 112 Cal. 288, 44 Pac. 568

Garbutt v. Chappe, 131 Cal. App. 284, 21 Pac. (2d) 594

Harris & Stunston, Inc. v. Yorba Linda Citrus Ass'n., 135 Cal. App. 154, 26 Pac. (2d) 654

Farmers Irrigation Co. v. Kamm, 55 Colo. 440, 135 Pac. 766

Chapin v. Persse & Brooks Paper Works, 30 Conn. 461

Hackfield & Co. v. Hilo Railroad Co., 14 Hawaii 448

Alexander Lumber Co. v. Farmer City, 272 Ill. 264, 11 N. E. 1012

Farmers Loan & Trust Co. v. Canada & St. Louis Ry. Co., 127 Ind. 250, 26 N. E. 784

Tipton Realty & Abstract Co. v. Kokomo Stone Co., 61 Ind. App. 681, 110 N. E. 688

Forsberg v. Koss Construction Co., 218 Iowa 818, 252 N. W. 258

Hightower v. Bailey, 108 Ky. 198, 56 S. W. 147

American Creosote Works v. City of Monroe, 175 La. 905, 144 So. 612

Staffon v. Lyon, 104 Mich. 249, 62 N. W. 354

Stephens Lumber Co. v. Townsend-Stark Corp., 228 Mich. 182, 199 N. W. 706

Vander Horst v. Apartments Corp., 239 Mich. 593, 215 N. W. 57

Carlisle v. Knapp, 51 N. J. Law 329, 17 Atl. 633

Bohnen v. Metz, 126 N. Y. App. Div. 807, 111 N. Y. Supp. 196 (affirmed 193 N. Y. 676, 87 N. E. 1116)

Herrmann & Grace v. City of New York, 130 N. Y. App. Div. 531, 114 N. Y. Supp. 1107

Edward E. Buhler Co. v. New York Dock Co., 170 N. Y. App. Div. 486, 156 N. Y. Supp. 457

Heddon Construction Co. v. Procter & Gamble Co., 62 N. Y. Misc. 129, 114 N. Y. Supp. 1103

Matzinger v. Harvard Lumber Co., 115 Ohio St. 555, 155 N. E. 131

Fisher v. Tomlinson, 40 Ore. 111, 66 Pac. 696

Brown v. Cowan, 110 Pa. 588, 1 Atl. 520

Huddleston v. Nislar, 72 S. W. (2d) (Texas) 959

Austin Bridge Co. v. Drake, 79 S. W. (2d) (Texas) 677

Baker v. Yakima Valley Canal Co., 77 Wash. 70, 137 Pac. 342

Neary v. Puget Sound Engineering Company, 114 Wash. 1, 194 Pac. 830

Marsh v. Rothey, 117 W. Va. 94, 183 S. E. 914

Builders Lumber & Supply Co. v. Chicago Bonding & Surety Co., 167 Wis. 167, 166 N. W. 320.